No. 14533

In The United States
COURT OF APPEALS
For the Ninth Circuit

RUTH B. KERRY,

Appellant,

vs.

JOSEPH R. SCHNEIDER, Trustee in Bankruptcy of Harold Edwin Kerry and the community of Harold Edwin Kerry and Ruth B. Kerry, his wife, Bankrupt.

Appellee.

Upon Appeal From the United States District Court for the Western District of Washington Southern Division

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BRIEF OF APPELLEE

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Appellee.

UPON APPEAL FROM THE DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

BRIEF FOR THE APPELLEE

QUESTION PRESENTED

Should the Court grant appellant's petition to require appellee, as trustee in bankruptcy, to abandon bankrupt's right, title and interest in a partnership and allow appellant to foreclose a purported pledge thereof, upon a showing that nine months prior to the institution of bankruptcy proceeding bankrupt signed an instrument stating that he as-

signed to appellant his right, title and interest in the partnership as security until a note was paid in full, when bankrupt continued in full control of the partnership until bankruptcy; when nothing but the purported pledge agreement was delivered into the dominion and control of appellant; and when said agreement or notice thereof was not filed?

STATEMENT OF THE CASE

Both appellant and appellee are seeking the bankrupt's rights in the winding up of the West Tenino Lumber Company. This firm was a partnership consisting of the bankrupt and three other partners (R. 87-88). After payment of partnership creditors, bankrupt's portion represents a 45/88th interest (R. 90) in a remilling plant which buys lumber for the purpose of resawing and finishing (R. 102). Bankrupt's interest had a book value of $23,482.25 on November 31, 1953 (R. 10-11), a book value of $23,785.00 on March 18th, 1954 (R. 103) and a market value of $21,-917.00 on March 18, 1954 (R. 104). At all times between December 30, 1952, and the time of filing the petition in bankruptcy, the bankrupt's interest in the surplus of the partnership had a value of more than $10,000.00 (R. 131).

Appellant's claim to bankrupt's rights upon distribution of assets is based upon the following instrument signed by her husband:

"ASSIGNMENT

H. E. Kerry does hereby assign and set over to Ruth B. Kerry, all of his right, title and interest in and to the partnership known as West Tenino Lumber Com-

pany which is a partnership consisting of H. E. Kerry, C. L. Stickney, H. A. Preszler and Israel Torrico. Said assignment is substituted security for that certain pledge agreement entered into between H. E. Kerry and Ruth B. Kerry, dated July 28, 1952, and which security is to act as continuing security for that certain note dated July 28, 1952, until said note is paid in full.

Dated this 30th day of December, 1952.

/s/ H. E. KERRY"

which will be referred to as Exhibit 9 (R. 100).

The Referee in Bankruptcy concluded that Exhibit 9 is an incomplete pledge (R. 36). He found that appellant exercised no dominion or control over any partnership interest of the bankrupt (R. 35).

The appellant did not claim that the Referee erred in this finding when she made her petition for review before the District Court (R. 40 through 45).

The District Judge, in his memorandum decision said:

"The 'assignment' dated December 30, 1952, in fact is not an assignment but by its term purports to be a pledge of the bankrupt's partnership interest in West Tenino Lumber Company to secure indebtedness referred to in the document. Such character of the document was recognized by the parties in the hearing before the Referee (Tr. 34) and acknowledged by petitioner's counsel at the argument in this Court." (R. 48).

and

"From the record and the unchallenged facts found by the Referee it is clear that the partnership interest of the bankrupt was not relinquished by the bankrupt

or delivered to Mrs. Kerry. Accordingly, no valid pledge was completed under Washington law.

"The foregoing view of the matter makes it unnecessary to consider whether an incompleted pledge of a partnership interest is within the Washington definitions of either chattel mortgage or accounts receivable." (R. 49-50).

It was shown at the hearing before the Referee that on July 28, 1952, the bankrupt pledged two certificates of capital stock of the West Tenino Lumber Company, a Washington corporation, to secure a promissory note payable to appellant in the sum of $29,250.00 and maturing July 28, 1957 (R. 73-74-75). On December 30, 1952, appellant authorized bankrupt to vote the stock for the dissolution of the corporation and to form a partnership to be known as the West Tenino Lumber Company (R. 81-82). The trustee in liquidation of West Tenino Lumber Company, a Washington corporation, executed a bill of sale dated December 30, 1952, selling and transferring a 45/88th of all of the assets of the corporation to bankrupt (R. 94-95-96). The property consisted of a lessee's interest in a lease from the Northern Pacific Railway Company and other assets (R. 94-95-96). The bill of sale transferred a 23/88ths interest to Israel Torrico, a 17/88th interest to Charles L. Stickney and a 3/88ths interest to H. A. Preszler (R. 94). The bill of sale was filed on the same day with the Auditor of the county where the property was located (R. 96-97).

On the same day bankrupt signed Exhibit 9 (R. 100) and bankrupt, Charles L. Stickney, Israel Torrico and H. C.

Preszler signed an agreement forming the West Tenino Lumber Company partnership (R. 87 through 94) as had been directed and authorized by appellant (R. 81-82).

The partnership agreement provided that the capital of the partnership should consist of the assets which were transferred to the partners in the above bill of sale (R. 89), and bankrupt should own 45/88ths of the capital (R. 90). It also provided that bankrupt was to share 45/88ths in the net income, net losses and capital gains and losses of the partnership (R. 90). Withdrawals of profits were to be made by the partners at such time and in such amount as would be agreed (R. 91). Bankrupt was to act as managing partner with the right to delegate such duties as he may see fit (R. 91). Upon death of a partner during the term of the partnership, a corporation was to be formed and the estate of the deceased partner was to accept the proportionate share of capital stock of the corporation as complete settlement of his capital account in the partnership. The assets of the partnership were to be transferred to the corporation and all of the common stock of the corporation was to be distributed to the partners, including the estate of the deceased partner in proportion in which the capital in the partnership is owned by the partners (R. 92). Nothing was mentioned concerning distribution of profits or assets upon dissolution to appellant. It was agreed that the partners could alter any paragraph, clause, matter or thing in the partnership agreement (R. 93).

A certificate of firm name was filed on December 31,

1952, with the Clerk of the county where the business was conducted, stating that bankrupt, Charles L. Stickney, Israel Torrico, H. A. Preszler are all of the persons having an interest in the West Tenino Lumber Company (R. 97, 98, 99, 100). No certificate was filed showing that appellant had an interest in the partnership (R. 111-112).

Bankrupt, as manager of the partnership, had control of the use and distribution of the income of the partnership (R. 116). This income included $5,920.21 earnings in 1953 of which $3,027.60 was the earnings of bankrupt's interest (R. 10-11). Bankrupt, as manager, had controlling say in connection with the affairs of the partnership (R. 113).

Appellant had nothing to do with the partnership (R. 112). When appellee's counsel was foolish enough to open the door by asking appellant's husband what was delivered to his wife in the way of a pledge, appellant's counsel objected (R. 112). The question was not answered during the hearing.

Mrs. Kerry's name did not appear as having an insurable interest in any of the insurance policies on the property of the partnership (R. 116). In fact, her husband testified that as he understood the transaction she had no interest in the partnership (R. 112) despite the fact that there were profits (R. 10-11-116) and at all times after the formation of the partnership there was a surplus (R. 131).

Mrs. Kerry's name did not appear any place on the books and records of the company nor was any instrument filed with the company showing an assignment to her (R. 131).

It was stipulated by counsel that notice of execution of Exhibit 9 was not filed with the Secretary of State (R. 143).

SUMMARY OF ARGUMENT

Appellant's petition to have trustee abandon burdensome asset and permit her to foreclose pledge should not be granted because:

I. Section 60a of the Bankruptcy Act (11 U.S.C. §96a) defines preferences which will be set aside when made within four months before filing the petition initiating the bankruptcy proceeding and subsection (7) thereof provides that liens will be deemed made immediately before the petition initiating the bankruptcy proceeding, and thereby within four months thereof, if applicable state law requires recording, delivery or some other act that no lien obtainable by legal or equitable proceedings could become superior and compliance with the applicable state law is not had.

II. Applicable state law requires that the transaction upon which appellant relies for relief be perfected as one of the following:

A. A pledge

B. A chattel mortgage

C. A pledge or mortgage of an account

III. The transaction upon which appellant relies for relief was not perfected as:

A. A pledge because of absence of delivery and dominion in purported pledgee.

B. A chattel mortgage because of failure to properly

execute and file Exhibit 9.

C. A pledge or mortgage of an account because of failure to file notice thereof with the Secretary of State.

I. Voidable Preferences and Title of Trustee in Bankruptcy.

Section 60a of the Bankruptcy Act (11 U.S.C. §96a) defines preferences which will be set aside when made within four months before filing the petition initiating the bankruptcy proceeding and subsection (7) thereof which provides that liens will be deemed made immediately before the petition initiating the bankruptcy proceeding, and therefore within four months thereof, if applicable state law requires recording, delivery or some other act so that no other lien obtainable by legal or equitable proceedings could become superior and compliance with such applicable state law is not had. The text of subsection (7) is in the appendix.

Applicable portion of section 70c is as follows:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such creditor actually exists." (11 U.S.C., §110c.

II. Applicable state law requires that the transaction

upon which appellant relies for relief be perfected as a pledge, a chattel mortgage or a pledge or mortgage of an account.

In order to discuss applicable state law concerning requirements to perfect the purported lien upon which appellant relies, the transaction should be traced from the time of execution of Exhibit 9 until the hearing before the Referee in Bankruptcy.

By bill of sale filed December 30, 1952, bankrupt and others become the owners of an undivided interest in a lease from the Northern Pacific Railway Company together with other assets formerly owned by the West Tenino Lumber Company, a Washington corporation (R. 94-95-96). The other assets included a lumber remilling plant and necessary equipment that goes with it (R. 102).

On the same day the West Tenino Lumber Company partnership was formed by the owners of the undivided interests set forth in the bill of sale (R. 87 and 88). The capital of the partnership consisted of the assets which had been transferred to the partners by bill of sale (R. 89 and 90). Each partner owned capital in the partnership in proportion to the undivided interest he owned in the property (R. 90). Net income, net losses and capital gains and losses were to be shared by the partners in the same proportion (R. 90). Upon dissolution due to death of a partner, a corporation was to be formed and bankrupt or his estate was to get stock for his interest in the partnership. Exhibit 9 purportedly encumbering all of bankrupt's right, title and

interest in and to the partnership was signed on the same day (R. 100).

The security described in Exhibit 9 included bankrupt's three interests arising from the partnership.

R.C.W. 25.04.240 provides:

> "Extent of property rights of a partner. — The property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management."

Despite the fact that the statute distinguishes a partner's rights from his interest, all were described in Exhibit 9 (R. 100).

Although Exhibit 9 (R. 100) and the partnership agreement (R. 87-94) are separate and independent instruments, both were signed simultaneously (R. 32-33). It was within the power of appellant, bankrupt and his partners to include in the partnership agreement provisions recognizing that appellant was the owner of the property contributed as capital by bankrupt or that the 45/88th interest in the property was encumbered to secure the payment of the note described in Exhibit 9.

Bankrupt could not contribute an unemcumbered 45/88th interest in the property as capital in the partnership and simultaneously place an encumbrance on the property for appellant's benefit. The property was operated by the partnership independent of any control by the appellant (R. 112-113-114).

Obviously appellant failed to acquire title to or an encumbrance on this first partnership right of bankrupt.

The other right purportedly included in Exhibit 9 was the right to participate in management (R.C.W. 25.04.240 (3). This right was given to bankrupt in the partnership agreement (R. 91). Appellant took no active interest in and had nothing to do with the partnership (R. 112-113). Obviously appellant failed to acquire this right described in Exhibit 9 (R. 100).

The other property right of a partner is his interest in the partnership R.C.W. 25.04.240 (2) defined as his share of the profits and surplus. R.C.W. 25.04.260.

The bill of sale became effective as of the close of business on December 30, 1952. It follows that on the day of execution of Exhibit 9, no profits were involved. At that time the remilling plant and the lease from the Northern Pacfic Railway Company were the only assets of the partnership. On December 30th, 1952, bankrupt's interest in the surplus could only arise out of his ownership of a 45/88th interest in the lease and remilling plant. The division of the property rights of a partner into rights and interests is a convenient device to preserve the uninterrupted continuity of the firm during the partnership tenancy.

R.C.W. 25.04.250 provides that a partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

The incidents of this tenancy are such that during the term of the partnership the property is to be used for part-

nership purposes unless all partners consent.

The preservation of continuity in the partnership through this device does not divorce a partner's interest from his right in specific partnership property and his right to participate in management. Surplus and profits are dependent upon partnership property and management. To control partnership property and management is to control partnership profits and surplus.

Surplus is what is left of partnership assets or property after partnership liabilities are provided for.

Bankrupt testified as appellant's witness, as follows:

> "No, I don't think so. She had no interest in the - - in the West Tenino Lumber Company as such as I understand the transaction. She was the pledgee of my interest" (R. 112).

The testimony of appellant's witness that she had no interest in the partnership was not modified, altered or explained. This, together with the testimony concerning the acts of the parties placing the bankrupt in full dominion and control of everything connected with the partnership was substantial evidence supporting the Referee's finding that appellant exercised no dominion or control over any partnership interest of bankrupt (R. 35).

The appellant seeks to foreclose her purported pledge and thereby acquire bankrupt's rights upon distribution of assets in the winding up of the West Tenino Lumber Company. If successful she will get an undivided interest in the remilling plant after partnership creditors are paid. At all

times relevant to this proceeding, dominion and control of this plant was centered in bankrupt. As managing partner, he had the right to manage the partnership and to delegate such duties as he saw fit (R. 91 and 113). Appellant had nothing to do with partnership property or management (R. 112-113).

The dependence of surplus and profits upon management and partnership property can be illustrated by examining the partnership balance sheet dated November 31, 1953 (R. 10-11). On that date bankrupt's interest had a book value of $23,482.25. This book value represented bankrupt's undivided interest in the assets after provision was made for payment of partnership liabilities. During the first eleven months of 1953 the partnership earned $5,920.21 of which $3,027.60 represented bankrupt's share of the profits. From day to day, week to week, and month to month as there were partnership profits or losses the interest of the bankrupt changed. This change could only take place as partnership assets or liabilities increased or decreased. This took place as a result of management or property values.

I have pointed out that during the period of the partnership tenancy the bankrupt's ownership and interest was subject to certain restrictions, to preserve partnership continuity. The property was to be used solely for partnership purposes (R.C.W. 25.04.250 (2) (a). This necessarily cut off bankrupt's power to assign or dispose of his right to possess or use partnership property during the period of tenan-

cy (R.C.W. 25.04.250 (2) (b)). The restriction that during the tenancy the property was to be used solely for partnership purposes did not cut off bankrupt's right to assign, mortgage, or encumber his interest (R.C.W. 25.04.270 and R.C.W. 25.04.020). There is no provision in the uniform partnership act (R.C.W. 25.04.010) indicating an intention to change or repeal the requirements of the state law concerning delivery of possession, filing or other like overt act in order to perfect such assignment, mortgage or encumbrance as against third persons. As to creditors, this statute does not validate an otherwise void mortgage or encumbrance. The statute does not repeal the requirement of an acknowledgment, an affidavit of good faith and filing to perfect a chattel mortgage or the requirement of delivery of dominion and control to pledgee to perfect a pledge.

When such conveyance is legally executed it does not dissolve the tenacy in partnership. If a true assignment is involved, as to other partners, the assignee is entitled to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled (R.C.W. 25.04.270 (1)). After an assignment has been properly executed, assignee is entitled to receive assignor's interest after dissolution. The word assignee rather than the term recipient of the conveyance is used in connection with rights to profits and interest after dissolution in the above two sub-sections because a mortgagee or holder of an encumbrance was not intended to be included. A mortgagee or holder of an encumbrance would not be entitled to the

property until foreclosure. In addition a holder of a mortgage or encumbrance of nominal value would not be entitled to receive a partnership interest of substantial value.

The above two sub-sections define the rights of the parties included in the assignment "as against the other partners" and not as to creditors of individual partners.

Creditors of the bankrupt could reach his interest in the partnership by means of a charging order (R.C.W. 25.04.-280) rather than by attachment or execution (R.C.W. 25.04.250 (2) (c)). A judgment creditor could reach his interest through the appointment of a receiver (R.C.W. 25.04.280 (1)) or by foreclosure. (R.C.W. 25.04.280 (2)).

It would not be of considerable assistance to label bankrupt's right, title and interest in the partnership described in Exhibit 9 as tangible or intangible property and then jump to a conclusion as to whether immediately before the petition initiating the bankruptcy a creditor with a charging order or appellant would have superior rights. Consideration of the reason for requiring delivery of possession, filing or like overt act to effect a valid lien as to creditors and an examination of the facts in Washington cases dealing with the rights of holders of secret liens should help to reach a proper conclusion.

The tendency to invalidate secret liens has been increasing to protect creditors who may have extended credit upon the strength of apparent unencumbered ownership when means of legal notification are available.

Parties extending credit to bankrupt saw that he had do-

minion and control of the partnership (R. 91 and 113). It is a common practice to obtain credit information from commercial, trade or credit reporting agencies before giving credit. Examination of the records in the office of the Clerk of the county where the partnership operated its business revealed that bankrupt, Stickney, Torrico and Preszler were the only persons having an interest in the partnership (R. 97 through 100). Records of the County Auditor showed that the bankrupt owned an undivided 45/88ths of the partnership property. Exhibit 9 was not filed or recorded (R. 131 and 143). In fact, appellant's purported lien was so secret that her name did not appear on partnership books (R. 131).

In order to protect her secret lien, appellant relies upon the dicta of *Heermans v. Blakeslee*, 97 Wash. 647, 167 Pac. 128, to the effect that the chattel mortgage statute refers to tangible property. The Supreme Court nullified this dicta by construing questionable cases as involving tangible property and by construing security assignments of intangibles as pledges.

Ackerson v. Babcock, 132 Wash. 435, 232 Pac. 335. Assignment of landlord's interest in lease as security construed as chattel mortgage and void as to attaching creditor, due to failure to execute and file assignment as required by chattel mortgage statute. Case involved right to rent payable after signing of the assignment.

Farmers State Bank v. Scheel, 124 Wash. 429, 214 Pac. 825. Security assignment of lessee's interest in lease con-

strued as a chattel mortgage. The parties were seeking money due lessee because of summer fallow of land. Security assignment executed several months before money due. Court held security assignment not valid because not properly executed as a chattel mortgage.

Lloyd L. Hughes, Inc. v. Widders, 187 Wash. 452, 60 P. (2d) 243. Security assignment of money to become due on hop contracts in connection with crops to be delivered in the future. Held not the assignment of a mere chose in action and to be valid security assignment must be executed a chattel mortgage.

Peterson v. National Discount Corporation, 179 Wash. 108, 35 P. (2d) 1097. Security assignment of trade accounts held to be a pledge and invalid as to creditors due to dominion retained in pledgor.

Fales Co. v. Seiple Co., 171 Wash. 630, 19 P. (2d) 118. Security assignment of trade accounts held to be a pledge and that pledgee must obtain dominion of account to be valid as to creditors. The Court pointed out that the discussion of chattel mortgages in *Heermans v. Blakeslee* was not necessary for its decision.

First National Bank v. Farm Loan & Invest. Co. 140 Wash. 410, 249 Pac. 983. Assignment by tenant of his lease as collateral security held to be a chattel mortgage. Assignment made October 30, 1923. By terms of lease tenant was to be paid for all land fallowed during summer of 1924, at the rate of $3.50 per acre. Suit brought by assignee to recover money for land summer fallowed in 1924. Court said

had the assignment been absolute, a different question would be presented.

No case since *Heermans v. Blakeslee* has held that the property involved was intangible and therefore not the subject matter for a chattel mortgage.

Ackerson v. Babcock, 132 Wash. 435, 232 Pac. 335, decided that a security assignment must be executed as a chattel mortgage or a pledge to be valid as to creditors.

II. A. — A PLEDGE:

Appellant tried this case before the Referee in Bankruptcy upon the theory that the security involved in Exhibit 9 had been pledged (R. 3-4-5-6-52-61-105-112). The case was decided by the Referee on the theory that a pledge was involved (R. 26-36), and that the pledgee was not placed in dominion or control of the property which was purported to act as security (R. 35).

Appellant presented his appeal to the District Court on the theory that a pledge was involved (R. 48). The Judge decided that the pledge was not valid as to the trustee because from the record and the unchallenged facts found by the Referee it is clear that the partnership interest of the bankrupt was not relinquished by the bankrupt or delivered to Mrs. Kerry (R. 49).

Ackerson v. Babcock, 132 Wash. 435, 232 Pac. 335, and this case involved many of the same legal problems. There a landlord assigned his lease to secure the payment of a promissory note. Rent reserved in the lease was to be a share of the wheat to be grown on the land in the future.

The tenant harvested the wheat and placed it in a warehouse. The warehouseman was notified to receive the wheat in the name of the assignee for security, but a creditor of the landlord attached the wheat before warehouse receipts were issued.

The court said that the security assignment was not executed in compliance with the chattel mortgage statute requiring an acknowledgment, an affidavit of good faith and filing and therefore did not perfect a lien on the wheat as to the attaching creditor of assignor.

The court then said the question was whether there was such delivery of the wheat to the assignee for security as would constitute a valid pledge.

The property purportedly encumbered by the security assignment of a lease was personal property (wheat to be raised) which assignor would be entitled to receive in the future. The amount of wheat to be received was to be one-third of the crop. The number of bushels of wheat was unknown at the time of the assignment and was dependent upon the success or failure of the crop. The lease itself created a tenancy. The landlord assignor did not have the right to possess the land or the wheat until a date after the signing of the assignment. The security assignment did not give the assignee possession, dominion or control of the wheat.

Now that the West Tenino Lumber Company partnership has been dissolved by the bankruptcy of H. E. Kerry, the victor in this law suit will receive a 45/88th interest in a remilling plant after partnership creditors are provided

for. If the plant is sold in the process of winding up the partnership, a sum of money will be the subject matter of this litigation. This latter contingency will be discussed with *Farmers State Bank v. Scheel,* 124 Wash. 429, 214 Pac. 825, *First National Bank v. Farm Loan & Invest. Co.* 140 Wash. 410, 249 Pac. 983 and R.C.W. 63.16.010 et seq.

In *Peterson v. National Discount Corporation,* 179 Wash. 108, 35 P. (2d) 1097, an assignee of trade accounts took the position that it became the owner of trade accounts through the assignment in question. It was pointed out that the payment of interest and finance charges by the assignor is inconsistent with a sale. The purported assignment was held to be a pledge, void as against creditors of the assignor.

In *Fales Co. v. Seiple Co.* 171 Wash. 630, 19 P. (2d) 118, construed a written assignment of trade accounts given to secure an indebtedness as an incompleted pledge and void as to creditors.

In *Kietz v. Gold Point Mines, Inc.* 5 Wash. (2d) 224, 105 P. (2d) 71, the court stated that a written instrument which purportedly used shares of stock as security was an attempted pledge and void because the certificates remained in the possession of the officers of the corporation.

II. B — A MORTGAGE:

The Uniform Partnership Act recognizes that a partner's interest may be mortgaged.

> "A conveyance by a partner of his interest in the partnership . . . . " (R.C.W. 25.04.270)
>
> "Conveyance includes . . . . every . . . . mortgage

. . . " (R.C.W. 25.04.020)

Appellant's statement on page 39 of his brief that W. A. Paton in his Accountant's Handbook classifies leaseholds and partnerships in the same section, is in point as to the nature of bankrupt's interest.

Ackerson v. Babcock, 132 Wash. 435, 232 Pac. 335, held that a security assignment by a landlord of his lease must be executed in accordance with the chattel mortgage statute.

The words personal property in the Chattel Mortgage Statute (R.C.W. 61.04.010) should be construed to mean the same thing as the words personal property in the Uniform Partnership Act (R.C.W. 25.04.260).

> "Mortgages may be made upon all kinds of personal property . . ." (R.C.W. 61.04.010).
>
> "A partner's interest in the partnership is his share of the profits and surplus and is personal property." (R.C.W. 25.04.260).

II. C. — A PLEDGE OR MORTGAGE OF AN ACCOUNT:

R.C.W. 63.16.010 et seq requires that notice of any transfer, pledge, mortgage or sale of an open book account, mutual account, or account stated must be filed with the secretary of state to be effective as to creditors.

I have pointed out that the dicta of *Heermans v. Blakeslee,* 97 Wash. 647, 167 Pac. 128, to the effect that a trade account is intangible personal property and not the proper subject matter for a chattel mortgage is out of step with

later decisions, and now the legislature recognizes that broadly speaking all accounts may be mortgaged.

Appellant has taken the position that the security described in Exhibit 9 is an intangible and of the nature of the trade account discussed in *Heermans v. Blakeslee*, 97 Wash. 647, 167 Pac. 128, and for that reason is not the proper subject matter for a chattel mortgage. If the security mentioned in Exhibit 9 (R. 100) is an intangible comparable to a trade account, then appellant's failure to file notice of the assignment as required in R.C.W. 63.16.010 et seq makes her claim of ownership or lien inferior to the rights of a creditor at the time of filing the petition initiating the bankruptcy.

Record of bankrupt's interest in the partnership was kept in the partnership books. These books were kept open during the continuation of the partnership and will be kept open until the partners or their successors agree upon an account winding up the affairs of the West Tenino Lumber Company. The open book account will then become an account stated, *George v. Shepard,* 117 Colo. 135, 184 P. (2d) 473.

In this accounting the remilling plant and other personal property will be listed as assets. Liabilities will rank first amounts owing creditors other than partners, and second amounts owing partners (R.C.W. 25.04.400). If the remilling plant is sold and money is distributed an account will be owing the victor in this litigation.

III. A. THE TRANSACTION UPON WHICH AP-

PELLANT RELIES FOR RELIEF WAS NOT PERFECTED AS A PLEDGE BECAUSE OF ABSENCE OF DELIVERY AND DOMINION IN PURPORTED PLEDGEE:

It has been pointed out that a trade account by dicta first was said not to be proper security under the chattel mortgage statute and later a security assignment of such an account was held to be a pledge. The pledge theory was adopted by the courts as a result of a growing tendency to avoid secret liens.

In *Fales Co. v. Seiple Co.*, 171 Wash. 630, 19 P. (2d) 118, an assignment was made using the following language:

> ". . . do hereby sell, transfer and assign to first party (Fales Company) all of the accounts receivable . . . as security in the manner and to the extent herein provided." 171 Wash. 633 and 644, 19 P (2d) 119.

The court said:

> "The assignment was invalid as to the rights of third parties, inasmuch as there was no surrender by the assignor of dominion and control of the subject matter of the assignment, and assumption of dominion and control of that subject matter by the assignee. There is no showing of actual intent on the part of the respondent to defraud the creditors of the two defendant corporations; however, as to third parties the assignment was invalid in law." 171 Wash. 639, 19 P (2d) 121.

In *Peterson v. National Discount Corporation*, 179 Wash. 108; 35 P. (2d) 1097, the court said:

> "Three questions are presented by the appeal: (1)

> Did the transactions between the insolvent corporation and the appellant amount to sales of the accounts receivable, as counsel for appellant contend, or did the transactions constitute assignments of the accounts receivable as security for payment of loans of money? (2) If the accounts receivable were assigned to secure payment of loans, was there such retention of dominion by the assignor over the pledged accounts as invalidated the assignments, under the statute, Rem. Rev. Stat., Sec. 5831-2 (P.C. Sec. 4532-2), and under the rule enunciated in *Fales Co. v. Seiple Co.*, 171 Wash. 630, 19 P. (2d) 118, and in *Benedict v. Ratner*, 168 U.S. 353, 45 S. Ct. 566. (3) Was appellant lender entitled to credit for money advanced to the insolvent borrower during the period of four months immediately preceding the receivership?" 179 Wash. 113 and 114, 35 P. (2d) 1100.

The assignment used the words "sells, assigns and sets over" to the assignee all its right, title and interest in and to accounts receivable listed.

The court said that the position of the assignee that the accounts were sold, is not tenable and held that there was a pledge because the accounts were assigned to secure the payment of loans.

The court added:

> "The assignor was permitted, with the knowledge of the appellant assignee, to allow credits to debtors upon assigned accounts for merchandise returned, and was also permitted to make adjustments and allow other credits. That, alone, constituted an exercise by the assignor grinding company of such dominion over

> the assigned accounts as invalidates the assignments, under the doctrine of *Benedict v. Ratner*, supra, and *Fales Co. v. Seiple Co.*, supra." 179 Wash. 117, 35 P (2d) 1101.

During the tenancy in partnership, the bankrupt and his partners had dominion and control of partnership property, profits and surplus. Without consent or approval of the appellant they could hold, sell, lease, transfer or exchange the plant. They could conserve, speculate or dissipate the assets. Their dominion was limited only by their ingenuity, energy, desire and the laws which govern business enterprise. This dominion and control was centered in the bankrupt as managing partner (R. 91). His policy determined increases or decreases in profits and surplus. The partners determined if and when profits would be distributed. They had power to amend the partnership agreement (R. 93) and extend the period of the partnership tenancy indefinitely. Their power was unlimited as to partnership profits and surplus. The Referee found that appellant exercised no dominion or control over the partnership interest of the bankrupt. This finding is an ultimate fact. It required no finding as to the evidence behind it. There was no evidence presented showing such dominion and control in appellant.

In *Peterson v. National Discount Corporation*, 179 Wash. 108, 35 P. (2d) 1097, only a small percentage of the accounts pledged involved credits for merchandise returned or other adjustments. Despite this fact all accounts purportedly pledged were turned over to the receiver. Exhibit 9

included all of bankrupt's right, title and interest in the partnership. If a part described in the pledge is invalid, the whole pledge must fall.

Bankrupt had controlling say in the partnership (R. 113). Certainly his dominion and control was more complete than that of the pledgor in the *Peterson* case. In fact, appellant didn't know what assets would be included in profits, if any, and surplus until the partnership was wound up. Her dominion and control of anything connected with the partnership until bankruptcy was nil.

In *Hastings v. Lincoln Trust Company,* 115 Wash. 492, 197 Pac. 627, the court distinguishes transactions which may be valid as between the parties but void as to creditors, and then said:

> "It is elementary law that the delivery of pledged property by the pledgor to the pledgee is absolutely necessary to the life of the contemplated pledge. It is well said in *Security Warehousing Co. v. Hand,* 143 Fed. 32 (41):
>
> "Delivery of possession is the very life of a pledge. No mere agreements respecting possession can create it. The contract of pledge cannot exist outside of the fact of change of possession." 21 R.C.L. 643.
>
> "It is of course not necessary, under all circumstances, that the delivery be an actual physical movement of the property from the hands or control of the pledgor to the pledgee; but it must in any event be of such nature that the control and dominion of the pledge passes from the pledgor into the absolute control and dominion of the pledgee." 115 Wash. 499 and 500, 197 Pac. 629.

In *Kietz v. Gold Point Mines, Inc.*, 5 Wn. (2d) 224; 105 P. (2d) 71, the court considered an assignment purportedly pledging shares of capital stock of a corporation. The court decided that the execution of the assignment purporting to pledge the stock was not delivery of the subject matter of the pledge. The certificates of stock were held by the issuing corporation. The court held that the corporation was not chosen by pledgor and pledgee to hold the certificates for pledgee, nor did the corporation agree to hold the certificates for the pledgee and therefore the issuing corporation was not holding the certificates for the pledgee.

The court said:

> "In passing upon the question of necessity of delivery of personal property to complete a pledge, this court stated in *Kuhn v. Groll*, 118 Wash. 285, 203 Pac. 44:
>
> "It is true that the law requires a delivery of the pledged property from the pledgor to the pledgee and a retention of it by the pledgee in order to make the pledge fully effectual as security. We think the law applicable to the situation we find here is well stated in 21 R.C.L. 643, as follows:
>
> "The requirement of possession is an inexorable rule of law, adopted to prevent fraud and deception, for, if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods. If, however, the pledgee has the thing already in his possession, the very contract transfers to him, by operation of law, a virtual possession thereof as a pledge the moment the contract is completed." 5 Wn. (2d) 229, 230; 105 P.

(2d) 74.

There is no evidence that the bankrupt or the other partners were holding anything connected with the partnership for appellant. As pointed out in the last case discussed, they were not chosen to hold anything for appellant nor did they agree to hold anything for her.

III. B. The Transaction Upon Which Appellant Relies for Relief was Not Perfected as a Chattel Mortgage Because of Failure to Properly Execute and File Exibit 9.

A chattel mortgage must be acknowledged, filed and have an affidavit of good faith to be valid as to creditors. R.C.W. 61.04.020.

Degginger v. Seattle Brewing and Malting Company, 41 Wash. 385, 83 Pac. 898, is not only interesting in that it was decided at a time when a liquor license was assignable as a matter of right and for that reason was held to be intangible property, but also in that it held that a security assignment of such a license must be filed and executed in accordance with the chattel mortgage statute to be valid as to creditors. This case has never been reversed despite the dicta in a few cases that personal property as set forth in the chattel mortgage statute does not include intangible personal property.

It was mentioned before in this brief that in the event a sum of money rather than an undivided interest in the plant is distributed to the partners after the West Tenino Lumber Company is wound up *Farmers State Bank v.*

Scheel, 124 Wash. 429, 214 Pac. 825, and *First National Bank v. Farm Loan & Invest. Co.,* 140 Wash. 410, 249 Pac. 983 are in point.

Each of these cases involved the right of a security assignee to a sum of money due assignor for the summer fallow of land. Both cases decided that the instrument assigning the sum of money to be due the security assignor under the terms of a lease, to be valid had to have an affidavit of good faith and an acknowledgment and be filed in accordance with the chattel mortgage statute.

See *Ackerson v. Babcock,* 132 Wash. 435, 232, Pac. 335, discussed in this brief on page 18, wherein a security assignment of a lease by a landlord who did not have the right to possess the land was held to be a chattel mortgage and invalid as to attachment creditor of landlord because the assignment did not have an affidavit of good faith, an acknowledgment and was not filed.

Appellant stipulated that Exhibit 9 was not filed (R. 143). It did not have an affidavit of good faith or an acknowledgment (R. 100).

III. C. The Transaction Upon Which Appellant Relies For Relief was Not Perfected as a Pledge of an Account Because of Failure to File Notice Thereof With the Secretary of State:

R.C.W. 63.16.030 provides:

> "Notice of Assignment—Filing. No assignment of an account shall be valid as against present or future creditors of the assignor, or as against a subsequent

assignee of such account without knowledge of such assignment, unless such assignment shall be in writing and be signed by the assignor, and unless there shall be on file in the office of the filing officer, at the time of the making of such assignment or within ten days thereafter, an effective and uncanceled notice signed by the assignor and the assignee, in substantially the following form:

NOTICE OF ASSIGNMENT OF ACCOUNTS RECEIVABLE

Date.....

..... has assigned or intends to assign one or more accounts receivable to.....

....

Signature of Assignee *Signature of Assignor*

....

Address of Assignee *Address of Assignor*"

R.C.W. 63.16.010 (6) provides:

"DEFINITIONS. "Filing officer" means the secretary of state."

Appellant stipulated that notice of Exhibit 9 was not filed with the secretary of state (R. 143).

EXPLANATION OF AUTHORITIES CITED BY APPELLANT

Heermans v. Blakeslee, 97 Wash. 647, 167 Pac. 128, cited by appellant as a leading case for the proposition that the chattel mortgage statute does not refer to intangible property, was explained in *Fales Co. v. Seiple Co.* 171 Wash. 630, 19 P. (2d) 118. This case involved a security assignment of a trade account. The court made the following statement:

"*Heermans v. Blakeslee,* 93 Wash. 595, 161 Pac. 489

97 Wash. 647, 167 Pac. 128, is not in point. Heermans, an assignee of a portion of the accounts receivable of a water company, sought an accounting from the defendant Blakeslee for moneys received by the latter through writs of garnishment issued upon a judgment rendered in favor of Blakeslee against the water company, which had assigned to Heermans present and future earnings, etc. Heermans also prayed for an order restraining Blakeslee from causing to be issued additional writs of garnishment against the debtors of the water company. The plaintiff claimed that, as assignee of the water company, he was entitled to all the moneys so acquired and sought to be acquired, by Blakeslee. Defendant's Demurrer to the complaint was sustained and the action dismissed. The judgment was affirmed on appeal. We said:

"The complaint alleges that the suing out of the writs of garnishment is impairing appellant's contract of assignment and impairing his said security, but we find no allegations in the complaint to support these conclusions of law. Since the contract of assignment was an assignment in effect of one-half of the income of the water company, then, before the security of the appellant could be impaired, it was necessary to set out facts which would show that the particular sums garnished were the property of the appellant, or that the respondent, in issuing writs of garnishment, was taking more than one-half of the income assigned by the water company to the appellant. Since the complaint does not show these facts, it is clearly insufficient to base a cause of action upon for an accounting, or for an injunction to restrain the respondent from collecting his judgment against the water company." *Heermans v. Blakeslee*, 97 Wash. 647, 167 Pac. 128,

129; 171 Wash. 645, 646, 19 P. (2d) 123.

Judge Boldt stated that the "assignment" dated December 30, 1952, in fact is not an assignment but by its terms purports to be a pledge (R. 48).

In *National Bank v. Farm Loan & Invest. Co.* 140 Wash. 410, 249 Pac. 983, the court held a security assignment of a lease was a chattel mortgage and added, had the assignment been absolute a different question would be presented.

Appellant failed to distinguish assignments from security transactions in his brief.

In *Hammer v. O'Laughlin,* 8 Wash. 393, 36 Pac. 257, the appellant claimed that the bill of sale in question was a chattel mortgage and to be enforcible as to creditors it had to be executed and filed as a chattel mortgage. The court said:

> "The substance of such testimony was that he was the owner of the property by virtue of a sale to him evidenced by said bill of sale; that the firm was indebted to him for a large sum of money, and was responsible for the obligations of certain of the men in its employ; that the property was sold to him for the purpose of paying such indebtedness, and if sufficient proceeds could be derived therefrom, also paying the obligations of the men. Such testimony directly negatived any idea on the part of the parties to the sale that any right to the property or to who made the bill of sale. Such being the fact, there was nothing in the transaction which would change the presumption that the bill of sale was what it purported to be." 8 Wash.

394, 36 Pac. 257.

Bankrupt did retain a right to the property encumbered. Exhibit 9 was given to act as continuing security until the note was paid in full. The acts of the parties after Exhibit 9 was signed proved that bankrupt retained a right to the property.

The following cases cited by appellant involved absolute assignments and are to be distinguished from Exhibit 9 (R. 100) which was given as security "until said note is paid in full."

Bellingham Bay Boom Co. v. Brisbois, 14 Wash. 173, 44 Pac. 153, 46 Pac. 238, involved an absolute assignment. Mortgages and pledges were not considered.

Cox v. Bateman, 139 Wash. 135, 245 Pac. 928 involved an absolute assignment and not a pledge or a mortgage. The court said:

> "Whatever amounts were received by the bank were to be applied as of the date of the receipt, on the notes." 139 Wash. 136, 245 Pac. 928.

Mortgages and pledges were not considered in this case.

Horchover v. Pacific Marine Supply Co., 171 Wash. 330, 17 P. (2d) 915, involved rights under an absolute assignment in payment of a debt. The court did not consider whether a mortgage or pledge was involved.

Lloyd L. Hughes, Inc. v. Widders, 187 Wash. 452, 60 P. (2d) 243, is explained on page 17 of this brief.

R.C.W. 25.04.270 is explained on page 14 of this brief.

CONCLUSION

It is respectfully submitted that Exhibit 9 is not valid as

to the trustee in bankruptcy, and that the order of the District Court should be affirmed in all respects.

Respectfully,

STANLEY J. KRAUSE
For Appellee

APPENDIX

BANKRUPTCY ACT:

Section 60a (7) of the Bankruptcy Act (11 USC §96 (a) (7)) provides as follows:

(7) Any provision in this subdivision (a) to the contrary notwithstanding if the applicable law requires a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise, in order that no lien described in paragraph (2) could become superior to the right of the transferee therein, or if the applicable law requires a transfer of real property for such a consideration to be so perfected in order that no bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee, the time of transfer shall be determined by the following rules:

1. Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery, or some other act is required, and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time or where such stated period of time is more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer.

II. Where compliance with the law applicable to the transfer is not had in accordance with the provisions of

subparagraph I, the transfer shall be deemed to be made or suffered at the time of compliance therewith, and if such compliance is not had prior to the filing of the petition initiating a proceeding under this Act, such transfer shall be deemed to have been made or suffered immediately before the filing of such petition.

UNIFORM PARTNERSHIP ACT

Sections 1-2-25-26-27-28-40 (1) (2) (3) (R.C.W. 25.-04.010 - 25.04.020 - 25.04.260 - 25.04.270 - 25.04.280 - 25.-04.400 (1) (2) (3)).

"25.04.010 *Short title.* This chapter may be cited as the uniform partnership act.

"25.04.020 *Definition of terms.* In this chapter:

"Conveyance" includes every assignment, lease, mortgage, or encumbrance."

"25.04.250. *Nature of a partner's right in specific partnership property.* (1) A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

(2) The incidents of this tenancy are such that:

(a) A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.

(b) A partner's right in specific partnership property is not assignable except in connection with the assignment of

rights of all the partners in the same property.

(c) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt, the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

(d) On the death of a partner, his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.

(e) A partner's right in specific partnership property is not subject to dower, curtesy, or allowances to widows, heirs, or next of kin.

"25.04.260 *Nature of partner's interest in the partnership.* A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

"25.04.270 *Assignment of partner's interest.* (1) A conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor, as against the other partners in the absence of agreement, entitle the assignees, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs, or to require any information

or account of partnership transactions, or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled.

(2) In case of a dissolution of the partnership, the assignee is entitled to receive his assignor's interest and may require an account from the date only of the last account agreed to by all the partners.

"25.04.280 *Partner's interest subject to charging order.* (1) On due application to a competent court by any judgment creditor of a partner, the court which entered the judgment, order, or decree, or any other court, may charge the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with interest thereon; and may then or later appoint a receiver of his share of the profits, and of any other money due or to fall due to him in respect of the partnership, and make all other orders, directions, accounts and inquiries which the debtor partner might have made or which the circumstances of the case may require.

(2) The interest charged may be redeemed at any time before foreclosure, or in case of a sale being directed by the court may be purchased without thereby causing dissolution:

(a) With separate property, by any one or more of the partners, or

(b) With partnership property, by any one or more of the partners with the consent of all the partners whose in-

terests are not so charged or sold.

(3) Nothing in this chapter shall be held to deprive a partner of his right, if any, under the exemption laws, as regards his interest in the partnership.

"25.04.400 *Rules for distribution.* In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:

(1) The assets of the partnership are:

(a) the partnership property,

(b) the contributions of the partners necessary for the payment of all the liabilities specified in subsection (2) of this section.

(2) The liabilities of the partnership shall rank in order of payment, as follows:

(a) Those owing to creditors other than partners,

(b) Those owing to partners other than for capital and profits,

(c) Those owing to partners in respect of capital,

(d) Those owing to partners in respect of profits.

(3) The assets shall be applied in the order of their declaration in subdivision (1) of this section to the satisfaction of the liabilities.

Filing Notice of Assignment of Accounts

Section 1, "63.16.010 *Definitions.* As used in this chapter:

(1) "Account" or "account receivable" means an open book account, mutual account, or account stated, due or to become due, and not represented by a judgment, note,

draft, acceptance, or other similar instrument for the payment of money; it includes rights under an unperformed contract written or oral for work, goods, or services which in the regular course will result in an account receivable; it excludes conditional sales contracts.

(2) "Assignment" shall include any transfer, pledge, mortgage or sale of an account.

(3) "Creditor" means a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent.

(4) "Debt" means the indebtedness owing on an account.

|5) "Debtor" means any person by whom an account is owing to the assignor.

(6) "Filing officer" means the secretary of state.